RE: ABA MR 5.7
6/10/05 Commission Meeting
Open Session Item III.J.

M E M O

To: RRC

From: *Kehr
Sapiro
SeLegue

Date: May 10, 2005

Re: June 10, 2005 Meeting
Agenda Item III.J

1. Introduction.

At our April 2, 2005, meeting, the Commission approved proposed Rule 5.7 in principal, and our subcommittee was requested to provide a draft rule that takes account of the discussion at the meeting. Most of that discussion involved the application of the proposed rule to attorneys who provide fiduciary services. This lead to a rereading of much of the California authority that bears on this. We found an inconsistency in terminology in earlier cases and ethics opinions that requires us to choose terminology that necessarily cannot track all past California authority.

The essential problem is that many of our authorities describe what this proposed rule calls "law-related" services as fiduciary services - an example would be the transactional lawyer who also provides business management advice. The cases that refer to "law-related" services as fiduciary services impose on the lawyer acting in that capacity all of the duties of lawyers. On the other hand, as suggested by Ellen and Kurt, the cases in the *Raley* and *Allen* line impose only confidentiality, conflict, and trust account duties; these cases refer to fiduciary services as such things as having the status of a corporate officer or director, as a partner in a partnership, or as an agent. We therefore cannot refer to fiduciary duties as do the older cases while maintaining the distinction between having all the duties of lawyers and having only the confidentiality,

conflict, and trust account duties. We therefore propose to create a distinction between law-related and fiduciary services, and it is necessary that the Rule and Comment make this distinction clear. Our proposed definition of "law-related" is in proposed Rule 5.7(a) and Comment [2]. Our proposed definition of "fiduciary" is in proposed Rule 5.7(e) and Comment [4].

2. Roads Not Traveled (For Now).

a. One of the topics raised at our April 2, 2005 discussion of this proposed rule is its possible connection to the current Board of Governors examination of whether lawyers who are full-time ADR providers should be allowed to elect inactive Bar status. Randy has provided us the materials on this.

i. To briefly summarize, the Board circulated for public comment (with an April 28, 2005 deadline) a proposal to amend Article I, Section 2, of the Rules and Regulations of the State Bar to clarify that a lawyer does not qualify for inactive status when continuing to provide arbitration or mediation services. The Bar report supports this by saying that the provision of ADR services is law-related (I use our proposed terminology, not the Board's language), that this outcome would be consistent with the way other law-related services have been treated (such as serving as real estate broker or accountant), and that inactive status is not appropriate in these situations b/c of the increased likelihood that those providing law-related services will become involved in the disciplinary system (the Board report states that inactive as well as active lawyer are subject to discipline). The full-time ADRs are concerned that their having active status will make it impossible for them to obtain low-cost insurance otherwise available to full-time ADR providers, will invite the Bar to regulate their ADR work, will increase their liability by defining their work as the practice of law, and might encourage more complaints against them.

ii. Most of these issues are separate from our work, but there is one possible intersection. This arises from what appears from the materials reviewed so far to be a misunderstanding on the part of the ADR providers that their work either is or is not the practice of law. In our view, the answer to that question is fact specific and depends on what a ADR provider says and does. For example, does the ADR provider in a particular situation disclaim a lawyer-client relationship with the parties, only serve as an adjudicator, give no legal advice to the parties, and draft no legal documents or do other things that amount to the practice of law? Proposed Rule 5.7 might be brought to the attention of the ADR providers and the Board as a way of clarifying to the providers that they have it

within their capacity to avoid the general responsibilities of lawyers by only furnishing ADR services and not any legal advice or representation.[1]

iii. There is a second convergence of the ADR issue and proposed Rule 5.7. This is the question of whether ADR services are fiduciary services under proposed 5.7(e) and, assuming they are, whether there is a conflict between the confidentiality and conflict requirement of our Rules and of other statutes or rules that might be applicable to them. Under our proposed Comment [10] the answer would be that, to the extent of any difference between the two standards, the higher one would govern.

b. Randy also provided Nace's draft, done I think well over a year ago, of a proposed revision to Rule 1-710, and a lengthy e-mail dated February 14, 2004, sent by Ira Spiro to the Commission to state his opposition to Nace's draft.[2]

i. The current version of Rule1-710 says: "A member who is serving as a temporary judge, referee, or court-appointed arbitrator, and is subject under the Code of Judicial Ethics to Canon 6D, shall comply with the terms of that canon." As the Discussion explains, this Rule merely makes a "member" subject to Bar discipline for violating Canon 6D while acting in a judicial capacity by court appointment. We do not see any implications that current Rule 1-710 has for proposed Rule 5.7, or vice versa.

ii. Nace's draft revision of Rule 1-710 included two changes. The first would broaden the Rule to include any lawyer while serving as a neutral in any mediation or settlement conference, and would obligate the lawyer to comply with the Judicial Council mediation standards found in Rules 1620-1620.9 of the

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[1]Since drafting this, I have had several communications with one of the opponents to the Bar's proposal that third-party neutrals may not take inactive status. These communications suggest to me the mistaken premise that a third-party neutral is not capable of practicing law, and that this conclusion is not fact specific. The only authority cited to me for this is *People v Sipper*, 61 Cal. App.2d Supp. 844 (1943). This is one of the many UPL cases, this one seeming to say that filling in the blanks in a printed form is not UPL. Citing this case here overlooks the distinction between the standard for the criminal prosecution of UPL (*Sipper* is a criminal prosecution) and the civil and disciplinary consequences of allowing a person to believe they are receiving services with all the benefits and protections of a lawyer-client relationship when the service provider either is not or can not provide those benefits or protections.

[2]Much of Ira's e-mail is outside the reach of Rule 5.7, and we therefore don't address that e-mail in an orderly way.

California Rules of Court. Nothing in proposed Rule 5.7 pertains to this change, and we don't comment on it here.

iii. Nace's second suggested change does raise Rule 5.7 issues. This change would impose on lawyers serving in a judicial capacity under court appointment all of the duties of the Rules. Nace's comment on this proposed change tells us it is based on the assumption that serving in a court-appointed judicial capacity is an ancillary business. We agree that these judicial services are either law-related or fiduciary, and this means his suggestion that all of the Rules should apply to lawyers while serving in court-appointed judicial role would be covered by proposed Rule 5.7. We recommend that this topic therefore be removed from proposed Rule 1-710 so it can be treated systematically way under Rule 5.7.

iv. Finally Nace's comment on his redraft raises the issue of whether the State Bar should be given the tools to discipline ADR neutrals. The State Bar's proposal regarding inactive status discussed above tells us that Nace's comment is based on a misunderstanding; the Bar does have the ability to discipline lawyers for their conduct while providing ADR services. We think a better question is whether the provision of ADR services should be treated as fiduciary services under Proposed Rule 5.7(e), to which only the confidentiality, conflict and trust account duties apply, or as law-related services, to which all the Rules would apply. This is likely to be a hot question b/c of the variety of ways in which ADR services are provided. For example, The Rutter Guide to Alternative Dispute Resolution at ¶3:529 says that some mediators actually draft the settlement agreement, that others won't do more than record the key terms, but that even the latter doesn't answer the question of whether the mediator is practicing law b/c of the possible tax and other implications of the deal points. The Rutter Guide at ¶3.125 says that some mediators accept that they are practicing law in serving as a mediator and treat the parties as joint clients from whom they obtain informed written consent.[3] We conclude from all of this that:

> (a) There is a substantive difference between the nature of the adjudicatory function of an arbitrator and the advisory function of a mediator;

[3]Ira Spiro's e-mail to the Commission argues against the application of the Rules to mediators, in part, b/c of what Ira describes as the conflict between the lawyer's duty of zealous representation and the mediator's duty of impartiality. Ira overlooks that in a joint client situation, the lawyer's duty of undivided loyalty requires the lawyer to not favor the interests of one client over the other. Rutter Guide's joint client alternative appears to be consistent with that principle.

(b) Despite this difference in roles, one can imagine a lawyer acting (presumably improperly) as an arbitrator in a matter in which one or more of the parties are clients of the lawyer. This should be treated as a law-related service under proposed Rule 5.7(b). If none of the parties to the arbitration is a client of the arbitrator, then the arbitration services should be treated as law-related under 5.7(c), allowing the lawyer-arbitrator to make it clear no legal services are being provided.

(c) The same is true of a lawyer who provides mediation services. If the lawyer is mediating between clients, the lawyer should be covered by 5.7(b). If not, the lawyer-mediator has the ability to make clear by word and deed that no legal services are being provided. The hard case is the lawyer-mediator who is acting in a small matter in which the parties are not represented by counsel and need the assistance of the mediator to prepare the settlement agreement. We do not see any principled basis for distinguishing these lawyer-mediators from all others. Perhaps the practical answer is for organizations to provide a form of settlement agreement that permits someone to merely fill in the blanks.

(d) We await the Commissions's discussions before suggesting any addition to the Comments directed to ADR issues.

PROPOSED RULE 5.7 RESPONSIBILITIES REGARDING LAW-RELATED AND FIDUCIARY SERVICES

A lawyer may provide to clients and to others law-related services, as defined in paragraph (a), and fiduciary services, subject to the requirements of this Rule.[4]

[4]In our March 1, 2005, memorandum to the Commission, we pointed out that Arizona's version of the Rule begins with the affirmative statement that lawyers may provide law-related services to clients and others. We recommended against the use of that language because we felt that no one could be in doubt about that right. On reconsideration, we have reversed our recommendation because the use of that introductory statement is a convenient way to place the definition of "law-related" near the front of the rule, where it is most needed. M.R. 5.7 places the definition at the end, so the reader needs to read through the rule, reach the definition, and then repeat the process.

(a) The Meaning of "Law-Related Services".[5]

The term "law-related services" means services that lawyers reasonably would be expected to perform in conjunction with or as part of the practice of law, even if the services might lawfully have been performed by non-lawyers.

(b) When Both Legal and Law-Related Services Are Provided by the Lawyer.

A lawyer is subject to these Rules with respect to all legal and law-related services the lawyer provides at the same time to a recipient.[6]

(c) When Only Law-Related Services Are Provided by the Lawyer.

If a lawyer provides law-related services, but is not providing legal services to the recipient, the lawyer is subject to these Rules with respect to all law-related services the recipient reasonably believes are being provided subject to the protections of a client-lawyer relationship with the lawyer.

(d) When Law-Related Services Are Provided by a Nonlegal Organization.[7]

A lawyer is subject to these Rules, with respect to law-related services provided to a recipient by an organization with which the lawyer is affiliated in any way, if the recipient reasonably believes the services are being provided subject to the protections of a client-lawyer relationship with the lawyer.[8]

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[5]The Model Rule format does not include paragraph titles. We think the use of titles here would prove helpful by allowing the reader to identify quickly the pertinent parts of the Rule.

[6]We have used the word "recipient" rather than "client" because the application of the rule does not depend on first finding that an attorney-client relationship exists. This is consistent with the Model Rule. But fair warning: the Reporter's explanation of the 2002 change to the Model Rule's Comment [2] is that the change was to prevent "... an overly restrictive reading of [the Rule] to the effect that the provision of law-related services could never be distinct from the provision of legal services if directly provided by a lawyer or law firm, rather than by a separate entity." We propose just the opposite.

[7]Your Drafter has replaced the Model Rule's use of "entity" with "organization" to be consistent with the terminology of CRPC 3-600. Your Drafter made the same suggestion with Rule 5.5; if that suggestion is not accepted there, the terminology should be revisited here.

[8]The wording of (d) tracks that of (c); any change to one should be picked up in the other.

(e) When Fiduciary Services Are Provided by the Lawyer.

A lawyer is subject to the confidentiality and conflicts of interests provisions of these Rules with respect to the provision of fiduciary services, and is subject to the trust account rules with regard to all funds the lawyer receives in a fiduciary capacity. The term "fiduciary services" means services provided by a lawyer, other than in the capacity of the recipient's lawyer, when: (1) the nature of the lawyer's role imposes fiduciary duties on the lawyer; or (2) the lawyer's conduct creates a reasonable expectation that the lawyer owes a duty of fidelity to that person or organization.

(f) Avoiding the Duties of a Lawyer.

Paragraphs (c) , (d), and (e)(2)[9] do not apply if the lawyer makes efforts that are reasonable in the circumstances to avoid the recipient's belief that the protections of a client-lawyer relationship apply. Those efforts must include advising the recipient in writing[10] that the services are not legal services, and that the recipient will not have the protection of a client-lawyer relationship with respect to the law-related services being provided.

Comment[11]

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[9]Your Drafter makes the distinction between (e)(1) and (2) because in rereading *Raley, Allen*, and the more recent cases that follow them, I see no hint that a lawyer can obtain an advance waiver of his confidentiality, conflict, or trust account obligations when the fiduciary duties are imposed by law, as they are, say, with corporate officers or directors, partners in a partnership, or with the lawyer handling funds in a fiduciary capacity. On the other hand, if a lawyer is faced with the argument that he or she has fiduciary duties and a resulting conflict because of something the lawyer said or did, the lawyer should be allowed to respond.

[10]Florida Rule 4-5.7 is not mandatory on this, using the phrase "preferably in writing." The Model Rule relegates this issue to its Comment [6], similarly saying "... preferably should be in writing."

[11]These proposed Comments track the order of those in the Model Rule, but with rather heavy editing. We also have added Comment [2], which has no counterpart in the Model Rules. We have removed their Comment [5], which treats a lawyer's referral of a client to an organization controlled by the lawyer, b/c the fact of a referral is only one basis on which the recipient of the organization's services might reasonably associate its services with the lawyer; our proposed Rule 5.7(d) is considerably broader than the corresponding M.R. 5.7(a)(2). We have removed their Comment [8] b/c it is not applicable to our version of the Rule, which says that lawyers who provide both legal and law-related services to a recipient will not be given the opportunity to draw a distinction between them. We have removed their Comment [9] b/c it

[1] When a lawyer performs law-related or fiduciary services, or is affiliated with an organization that does so, there exists the potential for ethical problems. Principal among these is the possibility that the person for whom the law-related services are performed will not understand that the services might not carry with them the protections normally afforded as part of the client-lawyer relationship. The recipient of the law-related services might expect, for example, that the services are provided subject to the obligation of lawyers to protect confidential information, to avoid conflicting representations, and to act with undivided loyalty.

[2] Rule 5.7(a) defines "law-related" services based on the reasonable belief of the recipient of the services. That belief can be based on what the lawyer says or fails to say about the nature of the services being provided. This belief also can be based on the nature of the services, that is, if they call upon the lawyer to give legal advice or counsel, to examine the law, or to pass upon the legal effect of any act, document, or law.[12] Examples of law-related services include serving as the agent for a client in the sale of an airplane (*Kelly v. State Bar* (1991) 53 Cal.3d 509, 514-17), acting as the Executor of a Will (*Layton v. State Bar* (1990) 50 Cal.3d 889, 904), providing real estate title and brokerage services (*Crawford v. State Bar* (1960) 54 Cal.2d 659, 668), providing debt collection services (*Alkow v. State Bar* (1952) 38 Cal.2d 257, 263), and providing tax preparation services (*Libarian v. State Bar* (1944) 25 Cal.2d 314, 317-18).

[3] Rule 5.7(b) conclusively presumes that the Rules of Professional Conduct apply to all legal and law-related services the lawyer provides at the same time to a recipient. Without regard to the sophistication of the recipient, any attempted distinction between legal and law-related services being provided at the same time would be too vague to be reliable. For example, if a lawyer provides advice on business transactions while providing real estate brokerage services to the same recipient, Rule 5.7(b) conclusively presumes the lawyer could not make clear to the recipient of the services which services are given as a lawyer and which are not.

[4] Rule 5.7(e) recognizes that some doctrines of law not related specifically to lawyers can impose fiduciary duties on lawyers. See, *e.g.*, *William H. Raley Co. v. Superior Court* (1983) 149 Cal. App.3d 1042 [lawyer served as corporate director], *Huston v. Imperial Credit Commercial Mortgage Investment Corp.* (C.D. Cal. 2001) 179 F. Supp.2d

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appears only to be a pat on the back for lawyer providing law-related services rather than an explanation of the Rule.

[12]The last portion of the Comment is taken from Article I, Section 2, of the Rules and Regulation of the State Bar. It amounts to the definition of law-related services, the provision of which prevents a lawyer from opting for inactive status.

1157 [lawyer served as corporate officer], *In re Mortgage & Realty Trust v. Zim Co.* (C.D. Cal. 1996) 195 B.R. 740 [lawyer served as trustee]. This Rule also recognizes existing California requiring lawyers to handle under the lawyers' trust account rules all funds they receive in a fiduciary capacity, reflects law. See, *e.g.*, *Guzzetta v. State Bar* (1987) 43 Cal.3d 962, 979 and *Matter of Hertz,* (Rev. Dept. 1991) 1 Cal. State Bar Ct. Rptr. 456, 469-70. See [Rule 4-100].

[5] This Rule identifies the circumstances in which all of the Rules of Professional Conduct apply to the provision of law-related services by a lawyer, or particular Rules apply to the provision of fiduciary services by a lawyer. In either event, lawyers can be subject to discipline for conduct that might not amount to the practice of law. See, for example, B&P C §§6009 [attorney-lobbyists], 6009.3 [attorney-tax preparers], 6067 [lawyer's oath], 6068 [lawyer's duties], 6090.5 and 6100-6107 [various disciplinary provisions], 6131 [former prosecutors], 6175-6177 [lawyers selling financial products], and 18895, *et seq.* [attorney-athlete agents], 16, U.S.C. §1592, *et seq.*[Fair Debt Collections Practices Act], Welfare & Institutions C §14124.76 [obligation to notify Department of Health Services regarding receipt of personal injury judgment, award, or settlement], [and Rule 8.4].[13]

[6] Law-related services may be provided through an organization that is distinct from that through which the lawyer provides legal services. If a lawyer is affiliated with that organization in any way, the Rule requires the lawyer to take reasonable measures to assure that each person using the services of the organization knows that the services provided by the organization are not legal services and that the Rules of Professional Conduct that relate to the client-lawyer relationship do not apply. There will be many situations in which the lawyer's involvement with the organization will be unknown to the recipients of its services, and for that or other reasons there will be no reasonable basis on which the recipient could think the services are provided subject to the protections of the lawyer-client relationship; in these situations Rule 5.7 does not obligate the lawyer to communicate with the recipient about the lawyer's role.

[7] The communication required by Rule 5.7(f) should be made before entering into an agreement to provide or providing law-related services.

[8] The lawyer has the burden of showing that the lawyer has communicated to the recipient in a manner that reasonably should have been understood by the recipient[14] that the law-related services are provided without the protections of a client-lawyer

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[13]This is by no means a complete list. It might be appropriate to review the related statutes section of the gray book for additional examples.

[14]This replaces wording of the Model Rule's Comment [7] with language taken from current Rule 3-300(A).

relationship. For instance, a sophisticated user of law-related services, such as a publicly held corporation, might require a lesser explanation than someone unaccustomed to making distinctions between legal services and law-related services, such as an individual seeking real estate brokerage services or investment advice from someone he or she knows to be a lawyer.

[9] When a lawyer is obliged to accord the recipients of services the all protections of these Rules, the lawyer must take special care to heed the Rules addressing conflicts of interest [(Rules 1.7 through 1.11, especially Rules 1.7(a)(2) and 1.8(a), (b) and (f))] and the requirements of [Rule 1.6] relating to disclosure of confidential information. The promotion of the law-related services also must comply in all respects with [Rules 7.1 through 7.3], dealing with advertising and solicitation. Lawyers also should take special care to identify all obligations imposed by case law.[15]

[10] When the protections of the Rules do not apply to the provision of law-related services, the services are governed by principles of law external to the Rules, for example, the law of principal and agent or the rules of another profession in which the lawyer is licensed. Those other legal principles may establish a different degree of protection for the recipient with respect to confidentiality of information, conflicts of interest and permissible business relationships with clients. When the protections of the Rules do apply, the lawyer is obligated to provide services subject to the higher of the standard of the Rules and the external standard.

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[15]This tracks the Model Comment in tighter language. The Rule states that if a lawyer has the duties of a lawyer while providing law-related services, the lawyer has all those duties (as was said, for example, in Cal. State Bar Opn. 1999-154). Your Drafter questions if this Comment detracts from that general principal by highlighting particular Rules.